No. 108.

FILED
SEP 20 1945
CHARLES ELMORE CROPLEY
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1945.

HARRY EDISON,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

PETITIONER'S REPLY BRIEF.

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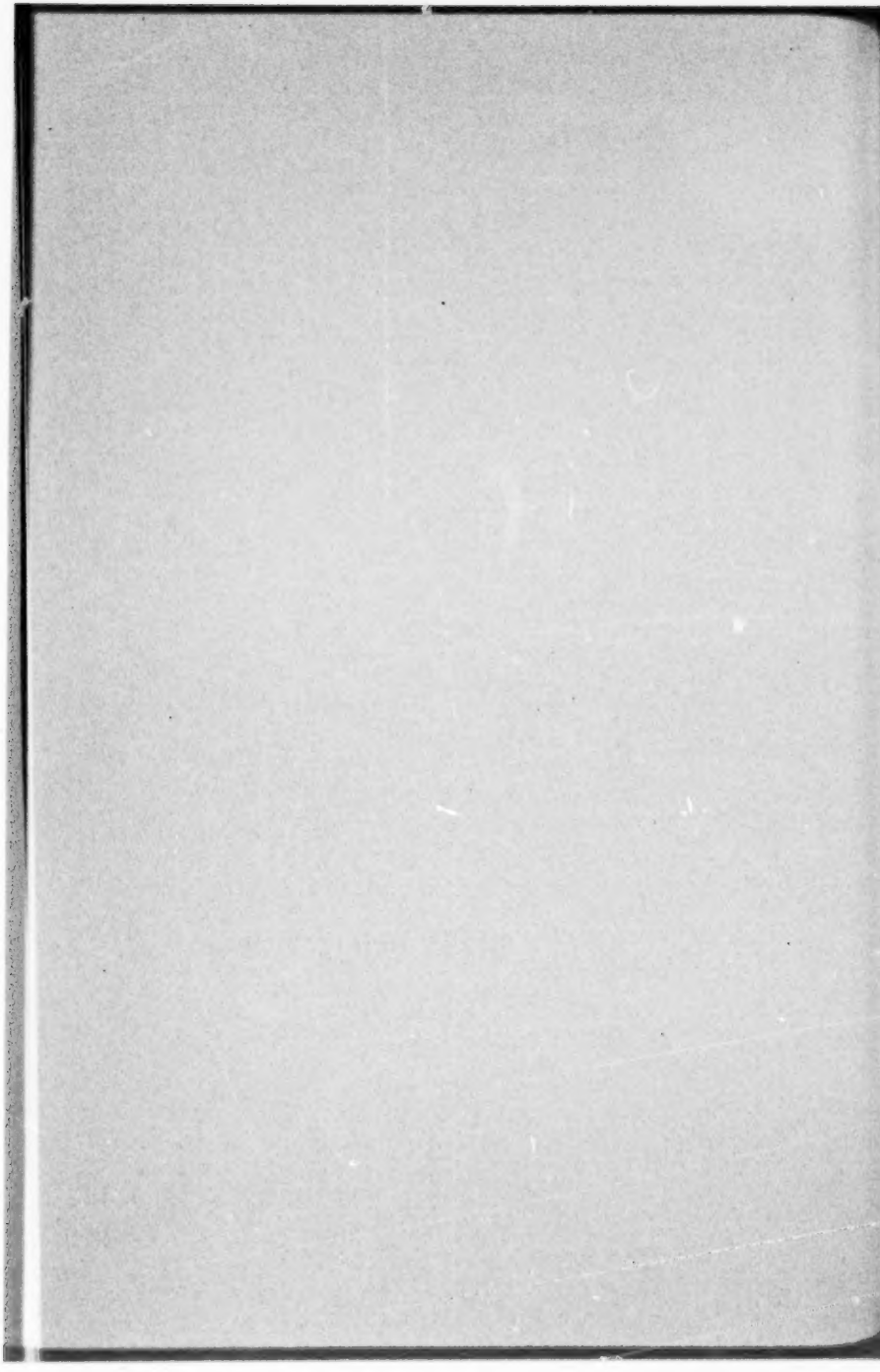

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PETITIONER'S REPLY BRIEF.

The petitioner respectfully submits that the question presented is incorrectly stated by respondent in his brief (p. 2) when he states that the question is whether the Tax Court erred in holding that under Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code, petitioner, the grantor, is taxable on the income from two long term trusts under which he retained broad administrative powers over the trust corpora and such control

over the distribution of the trust income and corpora as enabled him to shift beneficial interests in the trusts as between members of his family group. The question presented is properly stated in the Petition for Writ of Certiorari filed herein by petitioner (pp. 8-9). The misstatement of the question by the respondent is primarily in his assertion that the taxpayer, the grantor, retained broad administrative powers over the trust corpora and such control over the distribution of the trust income and corpora as enabled him to shift beneficial interests in the trusts as between members of his family group. First, the grantor (taxpayer) only retained the right as grantor to name successor trustees to those designated by him as successor trustees in the trust instruments; all other powers were vested in the trustee. Second, there is no power even in the trustee to shift beneficial interests in the trusts as between members of grantor's family group. The primary beneficiary has a vested interest only in that portion of the income which the trustee in his discretion might deem advisable or necessary for the comfort, support, education or ease of the primary beneficiary, and in that portion of the trust corpora as the trustee in his discretion should deem it advisable or necessary to pay over for the greater ease or comfort of the primary beneficiary or for his or her business training or to help him or her start in business or some other vocation or for his or her education, maintenance or care. The broad discretion vested by the language of the trust instruments in the trustee is subject to legal restrictions which the trustee may not ignore. See the opinion of Judge Learned Hand in Helvering v. McCormack, 135 Fed. (2d) 294, discussed in Petitioner's Brief in Support of Petition for Writ of Certiorari (pp. 35-36), specifically dealing with such powers of distribution and the opinion of Justice Cardozo in Carrier v. Carrier, 123 N. E. 135, 226 N. Y. 114, wherein he used the following language:

> "His discretion was to be 'absolute and uncontrolled.' That does not mean, however, that it might be recklessly or willfully abused. He had made himself a trustee; and in so doing he had subjected himself to those obligations of fidelity and diligence that attach to the office of trustee. He had power to 'invest' the moneys committed to his care. He had no power, under cover of an investment, to loan them to himself. His discretion, however broad, did not relieve him from obedience to the great principles of equity which are the life of every trust. * * *"

The trustee has no right to shift beneficial interests. His duty is to pay over to those beneficiaries designated to receive same as much of the income and corpus as may be necessary for the purposes specifically stated and to retain the balance for ultimate distribution to those beneficiaries entitled to receive same. Once the need of the beneficiary to satisfy one of the designated purposes is established, there is no absolute discretion to ignore that need. The discretion vested in him only permits him to determine how much may be necessary to fill that need, and if the discretion is exercised in good faith and within reasonable limits and the result does not indicate an unreasonable, arbitrary, capricious or whimsical exercise of that discretion it will be binding, otherwise not. Courts will interfere, if necessary, to enforce a payment if the circumstances warrant. By the same token, as stated by Judge Hand, the trustee cannot ignore the rights of the remaindermen and give to the primary beneficiary that which the trust indicates should go to the remaindermen. Ergo, there is no power to shift the beneficial interests between members of the grantor's family group.

Respondent in his Brief in Opposition (pp. 11-12) states that none of the Circuit Courts of Appeals cases cited by petitioner involved trusts under which the grantor retained power to shift beneficial interests in the trust.

This refers to cases which petitioner cited in his brief where the facts were very similar and in some instances almost identical with the facts involved in the case at bar. These cases are set forth in petitioner's brief (pp. 20-26). This corresponds with the petitioner's contention that these cases cited by him, like the case at bar, do not involve the shifting of beneficial interests.

In trying to distinguish the cases cited by petitioner, respondent states with reference to Commissioner v. Armour, 125 Fed. (2d) 467 (C. C. A. 7th), that the trust income was currently payable to the beneficiary and the grantor had no power to accumulate it, but overlooks the fact that the grantor-trustee was charged to pay to her daughter all the income and such part of the principal as should be necessary during the daughter's lifetime for the daughter's support, maintenance and comfort.

With reference to Armstrong v. Commissioner, 143 Fed. (2d) 700 (C. C. A. 10th), wherein the Tax Court was reversed, respondent states that the trust income was to accumulate and become part of the corpus and the grantor had no power to pay it out before the termination of the trust. He overlooks that provision of the trust instrument involved in that case which, after providing that the entire net income was to be accumulated and become a part of the corpus, further provided as follows:

> "All income or principal shall be payable and deliverable only and personally to the Beneficiaries hereunder, and said property, or any portion thereof, or income therefrom, may be distributed to said Beneficiaries in equal portions at any time deemed advisable by the Trustee."

These provisions are found in the opinion of the Tax Court in Murphy Shannon Armstrong, 1 T. C. 1008, l. c. 1010-1011.

With reference to Commissioner v. Katz, 139 Fed. (2d) 107 (C. C. A. 7th), respondent states that the grantor had

power to accumulate the income or pay it out, but having accumulated the same, beneficiary got it later when he reached the age of 25 years. That is not so. The trust was created to last during the grantor-trustee's lifetime. The trust income could be accumulated or distributed in the trustee's discretion to his son during the son's lifetime and in the event the son died before termination of the trust, then to the son's lawful issue and in the event the son died without surviving issue before the termination of the trust, then in equal shares to petitioner's wife and petitioner's issue. Upon the termination of the trust the entire trust estate, including the accumulated net income, was to be distributed to petitioner's son, provided he had attained the age of 25 years, otherwise it was to be held until he attained the age of 25 years. In the event petitioner's son had predeceased petitioner, then it was to go to the son's lawful issue and if the son had no lawful issue then living, it was to go to petitioner's wife and petitioner's issue in equal shares. These facts parallel those in the case at bar, except that in the Katz case the trust instrument did not specify the purposes for which the trustee in his discretion might pay over part or all of the income, whereas in the case at bar there is. And further in the Katz case there was no right to encroach upon the principal, whereas in the case at bar the trustee has the right to encroach upon the principal for the purposes specifically stated. See the opinions in Commissioner v. Katz, 139 Fed. (2d) 107, l. c. 108-9, and 46 B. T. A. 187, l. c. 190-191.

Respondent attempts to distinguish Jones v. Norris, 122 Fed. (2d) 6 (C. C. A. 10th), by pointing out that the grantor had power to accumulate the income or pay it out, but if accumulated the same beneficiary got it later at the termination of the twenty year trust. That is not necessarily so. If the primary beneficiary died before the termination of the trust, the issue of the primary beneficiary got it under the terms of the trust.

The distinction that respondent attempts to make with reference to Phipps v. Commissioner, 137 Fed. (2d) 141 (C. C. A. 2nd), to-wit: that the local courts would have an effective control over grantor-trustee's exercise of his discretion to pay over or accumulate the income, supports our contention in the case at bar. The court in that case said that an arbitrary refusal on the part of the co-trustee to pay to the wife any of the income so that it would accumulate would induce the New York courts to interfere and compel the co-trustee to exercise a genuine discretion in the light of the purpose of the trust and equity would compel distribution. 137 Fed. (2d), l. c. 144.

Since the filing of the petition for certiorari in this case, the United States Court of Appeals for the Tenth Circuit handed down its decision on July 2, 1945, in the case of Hall v. Commissioner, which is in direct conflict with the decision below. Hall v. Commissioner reversed the Tax Court. The decision of the Court of Appeals is not officially reported and in order that this Court might have the benefit thereof it is printed in full as an appendix hereto. It is unofficially reported in 1945 Prentice-Hall Federal Tax Service, Paragraph 72608, and in C. C. H. Standard Federal Tax Reporter, Paragraph 9361.

In the Hall case the grantor created an irrevocable trust which was to last for fifteen years. The trust was created for the benefit of his four daughters and their issue. The grantor named himself as trustee and gave himself broad powers of administration. The Trustee was specifically authorized to distribute all of the income from the trust to the beneficiaries "in equal shares at any time in the discretion of the trustee" and in addition to the income the trustee was empowered at any time during the continuance of the trust to expend from the principal or income any sums reasonably necessary for the education and maintenance of the beneficiaries and for the "purpose of defraying the expenses of illness, emergency or other

extreme misfortune." The trust further provided that in the event of the demise of any of the named beneficiaries (daughters of the grantor-trustee) prior to the full distribution of the trust estate, the share of such beneficiary should be held for the use and benefit of her issue in equal parts under the same conditions to be expended in their behalf in the sole discretion of the trustee until the termination of the trust. It further provided that in the event of the death of all the beneficiaries without issue, the trust estate was to descend to the trustor or his wife if she survived. The grantor-trustee or his wife as immediate successor was granted "unlimited powers of investment, contract, compromise, sale, lease and otherwise. It being the intent of the trustor to grant the trustee the same power to deal with the property as trustee as the trustor has heretofore had with one limitation only," but all other successor trustees were limited in their powers of investment of trust funds to Government bonds and real estate mortgages in amounts not to exceed forty per cent of the actual value at the time of the invesment. Upon termination of the trust, distribution was to be made in accordance with the provisions hereinbefore mentioned. It was held that the grantor-trustee was not taxable with the income of the trust and the Tax Court, which found to the contrary, was reversed. The Court of Appeals, arguendo, in referring to the Stockstrom decision, points out that in the Stockstrom case the trustee was authorized in his discretion to withhold the distribution of income during his lifetime or the lifetime of the beneficiaries. This, we have seen from analysis of the other decisions, is not a controlling factor. It is a distinction without a difference.

Furthermore in the case at bar, as we have pointed out, the discretion vested in the trustee is a controlled discretion and it must be exercised for the purposes specified

in the trust. If anything at all, the facts in the Hall case were less favorable to the taxpayer than they are in the case at bar.

Respondent fails to distinguish the case at bar from a case like Commissioner v. Buck, 120 Fed. (2d) 775 (C. C. A. 2nd), where the grantor retained the power to shift beneficial interests in the trust. In Commissioner v. Buck the grantor reserved to himself during his lifetime the power at any time and from time to time to "alter or amend in any respect whatsoever" the provisions of the indenture relating to "the disposition of the income and principal of the trust estate or the separate shares into which the same may be divided, and to change any beneficial interest" thereunder. In the Buck case the Court of Appeals for the Second Circuit held that this gave the grantor the power to shift beneficial interests. In Phipps v. Commissioner, 137 Fed. (2d) 141 (C. C. A. 2nd), the Circuit Court of Appeals for the Second Circuit, which decided both cases, distinguishes the Buck case from the Phipps case, which involves facts more nearly like those present in the case at bar, and points out that in cases such as the one at bar there is no power to shift beneficial interests.

The respondent advances a rather naive argument when he states that some of the cases cited by petitioner which conflict with the decision below in this case, represent inconsistencies of the Tax Court rather than conflicts justifying review by this Court because in those cases the decisions of the Tax Court were affirmed. A simple answer is that when a Circuit Court of Appeals reviews a decision of the Tax Court involving a question of law the decision of the Appellate Court is a declaration on its part of the law and if its decision conflicts with that of another Circuit Court of Appeals a situation is presented justifying review by this Court.

The other points discussed by respondent are amply covered in petitioner's brief in support and there will be no further discussion thereof in order to avoid redundancy.

This case is a proper one for review by this Court. Trustee u/w of Bingham v. Commissioner, No. 932, last Term, decided June 4, 1945, and reported in Law. ed. Advance Opinions, Vol. 89, No. 16; Dobson v. Commissioner, 320 U. S. 489; Helvering v. Stuart, 317 U. S. 154. It involves a question of law reviewable on appeal as was recently held by the Tenth Circuit in Hall v. Commissioner, decided July 2, 1945 (1945 P.-H., par. 72608, not yet officially reported, but set out in the Appendix hereto).

Respondent points to the fact that a petition for certiorari was denied last term in George v. Commissioner, 145 Fed. (2d) 837, C. C. A. 8th, certiorari denied 323 U. S. 778. The issues in the George case were different from those involved in the case at bar and therefore the denial in that case is not a precedent to be applied in this case.

CONCLUSION.

For the reasons hereinbefore stated, it is respectfully submitted that this Court should grant the writ of certiorari prayed for.

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